the lower bound of the benchmark range or "forward looking, long run incremental cost" as supported by cost data provided by prospective entrants. Thus, a prospective foreign-affiliated entrant would have to lower rates in home markets a) to reflect a cost measure that even the Commission has conceded is at best a crude estimate based on very limited data, or b) provide extensive cost information and undergo costly and time-consuming rate proceedings in the US.

Complying with either of these conditions would add significantly to the costs of foreign-affiliated carriers and create in competitive advantage for incumbents. Thus, Lehr is recommending that the Commission impose significant new costs on foreign-affiliated firms, but not on domestic entrants.[28] Of course, the principal and only beneficiaries of this requirement are incumbent carriers in the US market that are not affiliated with carriers abroad. Certainly, there is no immediate short term benefit to US consumers of raising costs to competitors; and, most importantly, the Lehr Illustration does not claim, show or quantify any consumer welfare benefits in the long run. Indeed, to the extent that the new cost of service test is applied to incumbent foreign-affiliated carriers, consumers would be penalized by the requirement that such carriers raise their rates in accordance with the Lehr theory.

The Theory of Investment Implied by the Illustration Is Flawed. While the paper does not so characterize its main assertion, the core of Lehr's Illustration actually embodies a theory of investment and simply assumes -- without analysis -- that a specific investment strategy would be pursued by potential foreign-affiliated entrants. Thus, another way to test the probity of the results of the Illustration is to consider the merits of the investment theory it embodies.

[28] No such cost tests are applied to any US international carriers, despite the fact that not all markets in which they operate are perfectly competitive and with zero margins. If the US imposes such a requirement on foreign-affiliated carriers, it invites foreign administrations to reciprocate. This suggests the possibility that administrations abroad may in response undertake a level and degree of costing analysis of AT&T and other US international carriers that far exceeds what the FCC itself requires of those carriers.

The Illustration asserts basically that a foreign-affiliated entrant will use cash generated ("unfairly" or "uneconomically") from services sold in other markets to underwrite entry into US international services markets by purchasing an incumbent carrier with a substantial market share. Use of cash generated in one line of business -- even a regulated one -- to fund entry into another is not a violation of either the antitrust laws or the Commission rules. AT&T, for example, derived most, if not all, of the cash it used to acquire National Cash Register and to underwrite efforts to enter the computer business from regulated lines of business principally, we can reasonably suppose, from domestic and international long distance revenues. Strict application of the analysis and principles set forth by Lehr would have required the FCC to forbid the use of retained earnings from regulated businesses to enter unregulated business lines. And, the precedent would suggest the need for conditioning entry into competitive markets generally on consideration of the source of cash used to underwrite entry.

Whether such an investment by a foreign-affiliated carrier makes sense depends on several matters not addressed by Lehr. The market conduct in Lehr's Illustration is fraught with risk. First of all, such conduct would invite retaliation in US markets by carriers with significant market presence. Lehr assumes that incumbents will merely meet the lower price of the entrant, but standard economic models and casual observation of competitive markets make clear that incumbents might strike pre-emptively, or reduce rates further, or undertake various quality increasing/cost reducing promotional schemes and so forth.[29] Moreover, the reaction (ex ante or ex post) of incumbents is not limited to the US market, since incumbents may compete elsewhere with the prospective foreign-affiliated entrant. All of these possible reactions and outcomes will influence the expected return from investing in "squeezing an incumbent". While the payoffs are clear and risk free in the Lehr Illustration, they are not likely to be so unambiguous to a manager with capital budgeting responsibilities.

[29] See note 6 above for citations to the literature on theories and practices of market conduct in oligopolistic markets like this one.

A foreign-affiliated entrant undertaking to buy market share as imagined in the Lehr Illustration would also need to consider the regulatory risks of doing so. As suggested above, this kind of market behavior would be patently obvious to regulators and subject to sanction. The FCC will have strong incentives in the new competitive international telecommunications services environment to monitor and be alert to anticompetitive practices. And, given the very public nature of costs -- especially reseller costs -- it would be somewhat naive for fringe carriers to believe that they could either escape regulatory detection or, even if they could, to buy without risk, significant and profitable market shares.

Any prospective foreign-affiliated entrant contemplating investments to purchase market share in US international services markets and paying for it on a continuing basis must consider the near inevitability that the source of cash used will evaporate in the future. US initiatives on settlements, combined with the almost irresistible forces for liberalization and competition in foreign markets, ensure that the source of funds for such investment will continue to diminish. The WTO is an important force in this regard and is recognized as such by Lehr. Thus, any foreign carrier considering such an investment would do so in the context of the long term risks involved, the fact that opportunities for growth are limited (and not addressed in the Lehr Illustration) and the prospect that earnings from the investment will decline over time.[30]

Notwithstanding the simplicity of the Lehr Illustration, the practice he describes as a

[30] The Commission noted this point in a different context, when it observed that a foreign carrier must "maintain low prices and high accounting rates over a sufficiently long time period so as to inflict substantial economic harm to competitors." (Report and Order in the Matter Of Market Entry and Regulation of Foreign-Affiliated Entities, Federal Communications Commission, IB Docket, No. 95-22; adopted November 28, 1995, para. 70). Similarly, for the investment in "squeezing" to make financial sense, the returns must be fairly secure; they must grow; and they must be fairly large for some period of time. The Lehr Illustration is entirely static and addresses none of these investment criteria, while clearly indicating that the investment is rational and would be undertaken by foreign concerns. On the basis of the facts presented in the Lehr Affidavit, it is not possible to determine if the investment is likely to be advantageous. But, even those facts raise considerable doubts about the likely payoff from investing in "squeezing" large, integrated, facilities-based US competitors.

"squeeze" is both much less rational and much less likely to occur than he supposes. The risk, return and growth profile of investing cash in hand to attempt to buy market share at the expense of incumbent US carriers in US markets is far less attractive than suggested by the arithmetic of the Lehr Illustration.

The Lehr Proposal Diminishes Competition by Raising Rivals' Cost. Lehr properly inveighs against raising rivals' costs as a means of forestalling entry and weakening competition.[31] But, that is precisely the effect of the policy he advocates. Requiring potential entrants to give up revenue from other lines of business and to be subjected to cost of service regulation in other markets imposes very substantial additional costs on foreign-affiliated entrants.[32]

VI. Conclusions

Professor Lehr has attempted to make a case for restricting competition to US incumbent international service providers. His recommendation that the FCC raise barriers to entry to foreign-affiliated competitors would impose costs on competitors, deny U.S. consumers options and lower prices, prevent transfers of wealth from foreign carriers to US consumers and create an uneconomic precedent for administrations to emulate anticompetitive regulation abroad. The benefits to US consumers for imposing these costs on potential entrants are not established by Professor Lehr. The benefits of entry-forestalling regulations will for the most part be absorbed by incumbent suppliers who are thereby protected from competition.

---

[31] See Lehr Affidavit, p. 13 and note 18.

[32] For a discussion of the means used by incumbents to deter competitive entry, see John Vickers, "Strategic Competition Among the Few -- Some Recent Developments in the Economics of Industry", in Readings in Microeconomics, Tim Jenkinson, ed. (Oxford: Oxford University Press, 1996) pp. 3-21, especially pp. 15-18 and references there. Christian von Wiezsacker describes in another context the effect of imposing the regulatory requirements suggested by Lehr: "...a barrier to entry is a cost of producing which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry and which implies a distortion in the allocation of resources from a social point of view." Christian C. von Weizsacker, "A Welfare Analysis of Barriers to Entry", Bell Journal of Economics, 11 (2), 1980, p. 400.

VITAE

Larry F. Darby
Telecommunications Consultant
5335 Nebraska Avenue, NW
Washington, DC 20015

EDUCATION

Bachelor of Science in Social Science Education -- 1962
Ball State University -- Muncie, Indiana
Doctor of Philosophy in Economics -- 1971
Indiana University -- Bloomington, Indiana

EXPERIENCE

<u>Instructor in Economics</u> -- 1968-1969
Graduate School of Arts and Sciences
Indiana University
<u>Assistant Professor of Economics</u> -- 1970-1975
Graduate School of Business
Temple University -- Philadelphia, Pennsylvania
<u>Senior Economist</u> -- 1975-1976
Executive Office of the President -- Office of Telecommunications Policy
Washington, D.C.
<u>Chief of the Economics Division</u> -- 1977-1978
Federal Communications Commission
Washington, D.C.
<u>Chief of the Common Carrier Bureau</u> -- 1978-1979
Federal Communications Commission
Washington, D.C.
<u>Financial and Economics Consultant</u> -- 1980-1981
Darby Associates -- Telecommunications Consultants
Washington, D.C.
<u>Executive Director of Motor Carrier Ratemaking Commission</u> -- 1981-1983
United States Congress
Washington, D.C.
<u>Vice-President: Investment Banking Group</u> -- 1984-1988
Lehman Brothers (Shearson-Lehman)
New York, New York
<u>Telecommunications Consultant and President</u> -- 1989 to present
Darby Associates -- Telecommunications Consultants
Washington, D.C.

OTHER CURRENT ACTIVITIES

<u>Adjunct Professor of Telecommunications</u>, The George Washington University Graduate School; <u>Contributing Editor</u>, "Communications, Business and Finance"; <u>Adjunct Fellow</u>, The Economic Strategies Institute (Wash., DC); <u>Author</u> of numerous presentations and articles.

Publications: Larry F. Darby (1987- Present)

"Regulation Matters to Investment and Efficiency in Telecommunications" in Capital Formation: The Forces That Influence Investment, Telecommunications Reports International Journal, Vol.1, Issue No. 2, September/October 1997, pp. 1-10.

Competition in Wireless Telecom Services in the Gulf of Mexico, Appended to submission of Petroleum Communications, Inc. In WT Docket No. 97-112 (In the Matter of Cellular Service and Other Commercial Services in the Gulf of Mexico); July 2, 1997

"Impacts of the 1996 Telecom Act on Investment and Innovation", New Telecom Quarterly, vol. 5, Issue no. 2, Second Quarter, 1997, pp. 21-30.

Consumer Welfare Effects of Proposed Regulatory Treatment of LEC Broadband Costs, submitted with the comments of BellSouth Corporation and BellSouth Telecommunications, Inc. in CC Docket No. 96-112 (In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services), July 26, 1996.

Declaration of Dr. Larry F. Darby: In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, submitted with the comments of BellSouth Corporation and BellSouth Telecommunications, Inc. in Docket 96-112, June 10, 1996.

Defining the Relevant Market for 37-39 GHz Services, submitted to the Federal Communications Commission as appendix to Comments of the Advanced Radio Telecom Corp. In ET Docket No. 95- 183: RM 8553 and in PP Docket No. 93-253, ; In the matter of Amendment of the Commission's Rules Regarding the 37.0-38.6 GHz and 38.6-40.0 GHz Bands and Implementation of Section 309(j) of the Act -- Competitive Bidding 37.0-38.6 and 38.6-40.0 Ghz, respectively) March 4, 1996.

Digital Audio Radio: Critique of Economic Harm Studies, appended to Reply comments of Digital Satellite Broadcasting Corporation in FCC Notice of Proposed Rulemaking (Establishment of Rules and Policies for the Digital Audio Satellite Service in the 2310-2360 Frequency Band), General Docket No. 90-357, October 13, 1995

Economic and Financial Aspects of U.S. Commercial and Radio Broadcasting, appended to comments of Digital Satellite Broadcasting Corporation in FCC Notice of Proposed Rulemaking (Establishment of Rules and Policies for the Digital Audio Satellite Service in the 2310-2360 Frequency Band, General Docket No. 90-357, September, 15, 1995.

Policy Implications of Spectrum Valuation and License Auctions, Testimony before the Committee on Commerce, Science and Transportation of the United States Senate; July 27, 1995.

Analysis of AT&T Market Power in the Resale Marketplace, submitted with the comments of the

Telecommunications Reseller Association to the Federal Communications Commission in the matter of AT&T Petition to Be Declared a Non-Dominant Carrier, June 9, 1995.

Economic Impacts in Docket 93-61 -- Preliminary Estimates of Markets for Alternative Uses of the 902-928 Mhz Band, Appended to submission of Metricom Inc. in PR Docket 93-61 (In the Matter of Amendment of Part 90 of the Commission's Rules to Adopt Regulations for Automatic Vehicle Monitoring Systems); January 13, 1995.

"Telecommunications Capital Formation, Regulation and Economic Development: A Primer", New Telecom Quarterly, vol. 5, No. 3, August 1994, pp. 45-52.

Price Cap Reform, Financial Incentives and Exchange Carrier Investment, Appended to comments of the United States Telephone Associated in Federal Communications Local Exchange Carrier Price Cap Review Proceeding, CC Docket 94-1, May 9, 1994

Implementation of Broadcast High Definition Television: Costs, Risks and Burdens, Monograph prepared for Maximum Service Telecasters, Inc. (MSTV), July 17, 1992, 47 pp. (Circulated on Confidential Basis)

Broadcast HDTV Implementation: Strategic Considerations, Monograph prepared for Association of Maximum Service Telecasters (AMST), October 16, 1991, 42 pp. (Circulated on Confidential Basis)

Capital Formation in U.S. Telecommunications, submitted to the National Telecommunications and Information Agency of the Department of Commerce in response to NTIA Notice of Inquiry (55 Fed. Reg. 800--1990) In re: Comprehensive Study of the Domestic Telecommunications Infrastructure; May 24, 1990

"Regulatory Practices and Access to Capital Markets", in James H. Alleman and Richard D. Emmerson, eds., Perspectives on the Telephone Industry: The Challenge for the Future (New York: Harper & Row, 1989), pp. 25-40.

Economic Potential of Advanced Television Products, Monograph prepared for the National Telecommunications and Information Administration of the US Department of Commerce, April 7, 1988; 54 pp.

"Investment Notes", Communications, Business and Finance, Telecommunications Reports International, Inc., approximately 90 columns of commentary on telecommunications issues (1500-2000 words) published biweekly from February, 1994 to the present.

Assorted outlines and summaries of presentations at conferences and trade shows on economic, financial and regulatory issues in telecommunications.

Approximately a dozen appearances on the KMB Video Journal, (KMB Associates -- Terra Verde, Florida) addressing assorted telecommunications economic and policy issues.

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing document were sent this 31st day of October, 1997, via first class United States mail, postage prepaid, to the following:

The Honorable Reed E. Hundt*
Federal Communications Commission
1919 M Street, N.W.
Room 814
Washington, D.C. 20554

Commissioner Susan Ness*
Federal Communications Commission
1919 M Street, N.W.
Room 832
Washington, D.C. 20554

Peter Cowhey, Chief*
International Bureau
Federal Communications Commission
2000 M Street
Room 849
Washington, D.C. 20554

Douglas Klein*
International Bureau
Federal Communications Commission
2000 M Street, N.W.
Room 800
Washington, D.C. 20554

Commissioner James H. Quello*
Federal Communications Commission
1919 M Street, N.W.
Room 802
Washington, D.C. 20554

Commissioner Rachelle B. Chong*
Federal Communications Commission
1919 M Street, N.W.
Room 844
Washington, D.C. 20554

Diane Cornell, Chief*
Telecommunications Division
International Bureau
Federal Communications Commission
2000 M Street, N.W.
Room 800
Washington, D.C. 20554

International Transcription Services*
1919 M Street, N.W., Room 246
Washington, D.C. 20554

John L. Bartlett
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006-2304
Attorneys for Aeronautical Radio, Inc. (ARINC)

Frank Michael Panek
Room 4H84
2000 West Ameritech Center Drive
Hoffman Estates, IL 60196-1025
Attorney for Ameritech

Mark C. Rosenblum
Lawrence J. Lafaro
James J. R. Talbot
295 N. Maple Avenue
Room 3252H3
Basking Ridge, NY 07920
Counsel for AT&T

Michael K. Kellogg
Austin C. Schlick
Kellogg, Huber, Hansen, Todd & Evans
1301 K Street, N.W., Suite 1000 West
Washington, DC 20005
Counsel for BellSouth Corporation

William B. Barfield
David G. Richards
BellSouth Corporation
1155 Peachtree Street, N.E.
Atlanta, GA 30309

Joel S. Winnik
Hogan & Hartson, L.L.P.
Columbia Square
555 Thirteenth Street, N.W.
Washington, DC 20004-1109
Attorneys for BT North America, Inc.

Cheryl Lynn Schneider
BT North America, Inc.
North Building, Suite 725
601 Pennsylvania Avenue, N.W.
Washington, DC 20004

Margaret M. Charles
Maria L. Cattafesta
Swidler & Berlin, Chartered
3000 K Street, N.W, Suite 300
Washington, DC 20007
Counsel for FaciliCom International

Gérard Moine
Alain-Louis Mie
Jean-Louis Burillon
France Telecom
Public Affairs Directorate
6, Place d'Alleray
75505 Paris Cedex 15
France

Theodore W. Krauss
Danielle K. Aguto
France Telecom North America
555 13th Street, N.W.
Suite 1100 East
Washington, DC 20004

Jeffrey P. Cunard
Debevoise & Plimpton
555 13th Street, N.W.
Suite 1100 East
Washington, DC 20004
Counsel to France Telecom

Michael J. Shortley, III
Director, Regulatory Services
Frontier Corporation
180 South Clinton Avenue
Rochester, NY 14646

R. Michael Senkowski
John B. Reynolds, III
Todd D. Daubert
Wiley Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006
Attorneys for GTE Service Corp.

Ward W. Wueste
GTE Service Corporation
One Stamford Forum
Stamford, CT 06904

Gail L. Polivy
GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, DC 20036

Kailas J. Rao, Ph. D.
Richard E. Kinder, Jr.
Michael J. Flanigan
Indus, Inc.
777 East Wisconsin Avenue, Suite 1900
Milwaukee, WI 53202

Philip L. Verveer
Jennifer A. Donaldson
Gunnar D. Halley
Willkie Farr & Gallagher
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20036
Attorneys for Indus, Inc.

Junichiro Miyazaki
Counselor of Embassy of Japan
2520 Massachusetts Avenue, N.W.
Washington, DC 20008

Sanford C. Reback
Carol R. Schultz
Larry Blosser
MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006

Leslie Harris, President
New T&T Hong Kong Limited
5/F, New T&T Centre
Harbour City, Tsim Sha Tsui
Kowloon, Hong Kong

Janice Obuchowski
Michael Wack
NextWave Telecom, Inc.
1101 Pennsylvania Ave., N.W., Suite 805
Washington, DC 20005
Counsel for NextWave Personal Communications Inc.

Kevin McGilly
Rohit Menezes
Freedom Technologies, Inc.
1100 New York Avenue, N.W.
Suite 650 East Tower
Washington, DC 20005
Consultants to NextWave Personal Communications Inc.

Masanobu Suzuki
Executive Vice President
Nippon Telegraph and Telephone Corporation
Global Business Headquarters
20-2 Nishi-Shinjuku 3-chome Shinjuku-ku
Tokyo 163-14 Japan

Christopher M. Bennett
NYNEX Long Distance Company
1095 Avenue of the Americas
Room 3828
New York, NY 10036

Wei Fong
Pacific Communications Services Co., Ltd.
20 Floor, 169, Jen ai Road, Sec. 4,
Taipei, 106, Taiwan

Henry Goldberg
Joseph A. Godles
Mary Dent
Goldberg, Godles, Wiener & Wright
1229 Nineteenth Street, N.W.
Washington, DC 20036
Attorneys for PanAmSat Corporation

James D. Ellis
Robert M. Lynch
Timothy P. Leahy
175 East Houston, Room 1254
San Antonio, TX 78205
Attorneys for SBC Communications Inc.

Stanley J. Moore
5850 West Las Positas Boulevard
Pleasanton, CA 94588
Attorney for SBC Communications Inc.

Wayne V. Black
C. Douglas Jarrett
Brian Turner Ashby
KELLER AND HECKMAN LLP
1001 G Street, N.W., Suite 500 West
Washington, DC 20001
Attorneys for Shell Offshore Services Company

Albert Halprin
Randall Cook
Halprin, Temple, Goodman & Sugrue
1100 New York Avenue, N.W.
Suite 650 East Tower
Washington, DC 20005
Counsel for Société Internationale de Télécommunications Aéronautiques (SITA)

Leon M. Kestenbaum
Kent Y. Nakamura
Sprint Communications Company, L.P.
1850 M Street, N.W., 11th Floor
Washington, DC 20036

J. Jeffrey Craven
Jeffrey L. Ross
Patton Boggs, L.L.P.
2550 M Street, N.W.
Washington, DC 20037
Attorneys for Telecom Finland, Ltd.

Ng Cher Keng, Director (Policy)
Telecommunication Authority of Singapore
35 Robinson Road
TAS Building
Singapore 0106

Luis López-van Dam
General Secretary
Telefónica Internacional de España, S.A.
Jorge Manrique, 12
Madrid 28006
Spain

Alfred M. Mamlet
Maury D. Shenk
Colleen A.Sechrest
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, DC 20036
Attorneys for Telefónica Internacional de España, S.A.

Gary M. Epstein
Teresa D. Baer
Lathan & Watkins
1101 Pennsylvania Avenue, N.W.
Washington, DC 20004
Attorneys for Telefonos de Mexico, S.A. de C.V.

George Y. Wheeler
Koteen & Naftalin, L.L.P.
1150 Connecticut Avenue, N.W.
Suite 1000
Washington, DC 20036
Attorneys for Telephone and Data Systems, Inc.

Gregory C. Staple
R. Edward Prince
Koteen & Naftalin, L.L.P.
1150 Connecticut Avenue, N.W.
Suite 1000
Washington, DC 20036
Attorneys for Telstra, Inc.

Daniel L. Poole
1801 California Street, Suite 5100
Denver, Colorado 80202
Attorney for U S West, Inc.

Mary McDermott
Linda Kent
Keith Townsend
Hance Haney
United States Telephone Association
1401 H Street, N.W., Suite 600
Washington, DC 20005

Timothy R. Graham
Leo I. George
Joseph M. Sandri, Jr.
Barry J. Ohlson
WinStar Communications, Inc.
1146 19th Street, N.W., Suite 200
Washington, DC 20036

Paul J. Sinderbrand
William W. Huber
Wilkinson, Barker, Knauer & Quinn
1735 New York Avenue, N.W.
Washington, DC 20006
Attorneys for The Wireless Cable Association International, Inc.

Robert S. Koppel
Vice President, Legal & Regulatory Affairs
WorldCom, Inc.
15245 Shady Grove Road
Suite 460
Rockville, MD 20850-3222

Catherine Wang
Swidler & Berlin, Chartered
3000 K Street, N.W.
Suite 300
Washington, DC 20007
Attorneys for WorldCom, Inc.

John F. Lewis, Jr.
Assistant Director in Charge
National Security Division
Federal Bureau of Investigation
Washington, DC 20535

Jeffrey M. Lang
Deputy United States Trade Representative
Winder Building
600 17th Street, N.W.
Washington, DC 20508

Rebecca S. Weeks, Lt Col, USAF
Staff Judge Advocate
Carl Wayne Smith
Chief Regulatory Counsel,
Telecommunications, DOD
Defense Information Systems Agency
701 S. Courthouse Road
Arlington, VA 22204
For the Secretary of Defense

Roberta Schrock

Roberta Schrock

**hand delivered*